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No. 582

In the Supreme Court of the United States

OCTOBER TERM, 1931

WOODWARD REALTY COMPANY, INC., PETITIONER

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Georgia (R. 8–10) is reported in 44 F. (2d) 856. The opinion of the Circuit Court of Appeals (R. 17–24) is reported in 53 F. (2d) 821.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 13, 1931. (R. 24.) The petition for certiorari was filed December 21, 1931, and granted January 25, 1932. Jurisdiction is conferred upon this Court by Section 240 (a) of the

Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether under Section 206 of the Revenue Act of 1926 petitioner may deduct from its gross income for 1927, when it was affiliated with the Piedmont Savings Company and for which year the two companies filed a consolidated income-tax return, net losses sustained by the Piedmont Company in 1925 and 1926, when the two companies were not affiliated, despite the fact that the Piedmont Company had no net income for the year 1927.

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra,* pp. 33–41.

STATEMENT

Petitioner brought this suit in the United States District Court for the Northern District of Georgia to recover $5,026.22 (R. 3), representing income taxes and interest paid by petitioner for the year 1927 (R. 5). The petition set forth the following facts:

In the years 1925 and 1926 the Piedmont Savings Company sustained net losses of $43,478.25 and $410.82, respectively. (R. 4.) Petitioner concedes that it was not affiliated with the Piedmont Company in those years. (Pet. 3; Pet. Br. 13.)

During 1927 petitioner owned 96% of the capital stock of the Piedmont Company. The two companies filed a consolidated income tax return for

that year showing net taxable income to petitioner of $37,582.63 and a loss to the Piedmont Company of $453.80, making a combined net taxable income for the consolidated group for 1927 of $37,128.83, upon which a tax was paid. (R. 3.)

In May, 1928, petitioner and the Piedmont Company filed an amended consolidated income tax return, claiming as additional deductions in the computation of their net income for 1927 the net losses sustained by the Piedmont Company in 1925 and 1926. (R. 4.) The claim was denied by the Commissioner of Internal Revenue (R. 5), and this suit followed. A demurrer to the petition was sustained by the District Court. (R. 8–10.) Judgment was entered dismissing the petition (R. 10), which was affirmed by the Circuit Court of Appeals for the Fifth Circuit (R. 17–25).

SUMMARY OF ARGUMENT

A taxpayer has no right to any deductions from gross income except as created by statute. Section 206 of the Revenue Act of 1926 provides that if any taxpayer has sustained a net loss, it "shall be allowed as a deduction in computing the net income ~~for that year~~ of the taxpayer for the succeeding taxable year"; and if the net loss is in excess of the net income "computed without such deduction," the excess "shall be allowed as a deduction in computing the net income for the next succeeding taxable year." Since the privilege thus accorded is in the nature of an exemption from the ordinary scheme of taxation, which is on the basis of an an-

nual accounting of the business transactions for the taxable year, it should not be extended by implication, and any doubt as to the extent of the privilege should be resolved in favor of the normal mode of taxation.

Our position is that availability of the deduction under Section 206 is restricted to the elimination of the net income of "the taxpayer," and if "the taxpayer" has no net income for the taxable year, a net loss of the preceding year must be carried forward to the next succeeding taxable year. Such is the express mandate of the statute, and the rule established by the cases.

Petitioner's contention that "net income" may be a minus quantity and that the net loss deduction may therefore be taken even though the sum of "the taxpayer's" deductions under Section 234 is in excess of gross income runs counter to the common understanding of the word "income." Moreover, in the case where the net loss of the preceding year exceeds the net income of the taxable year computed without the net loss, petitioner's contention would lead to the inclusion in the sum which Section 206 (b) directs to be carried forward to the next succeeding year of items which Section 206 (a) directs shall not be so included. No such inconsistency appears when net income is interpreted in accordance with common understanding as meaning a positive sum.

Since the Piedmont Savings Company had no net income for 1927, it could not deduct its net losses of 1925 and 1926 in 1927. As the Piedmont Com-

pany could not make the deduction, neither could petitioner, it being settled that the affiliated group may not in a consolidated return take a deduction not available to the member corporations. Hence an affiliated group may take advantage of net losses suffered by a member before affiliation only to the extent that the member had net income for the taxable year for which the consolidated return is filed.

There is no inconsistency between this position and the fact that all the deductions under Section 234 may be taken upon the filing of a consolidated return regardless of whether the individual corporations had net income. Section 234 has no provision, like that of Section 206 (b), for carrying forward to the next succeeding taxable year the sum by which the deduction exceeds the net income calculated without such deduction; and the fair implication from Section 240 authorizing the filing of a consolidated return of net income, is that all the items of gross income and deduction resulting from the operation of two corporations as a business unit in the taxable year should be listed on the consolidated return. This implication does not extend to the deduction of net losses sustained by a member before affiliation, except in so far as expressly authorized by Section 206 (b).

Our assumption that "the taxpayer" referred to in Section 206 (b) is the Piedmont Company is justified by the language of Section 206 (b) and (c), and the definition of "taxpayer" in Section 2. It is well settled that each of the affiliated corpora-

tions filing a consolidated return remains "the taxpayer" and that the group is merely a tax computing unit, not the taxable unit.

In two respects the purpose of Section 240, under which the consolidated return was filed, militates against the result sought by petitioner. Congress sought to prevent tax evasion by Section 240. If petitioner's contention be sustained, this Court would sanction the tax-evading practice by which a corporation earning a large net income purchased for a nominal consideration the stock of a corporation which had a large net loss for the preceding year, filed a consolidated return, and secured a large reduction in tax by means of the affiliation. Although affiliated corporations are now allowed the benefit of net losses sustained by a member corporation before affiliation, even though the latter has no net income for the taxable year for which the consolidated return is filed, tax evasion of the kind described is prevented by the restriction that the amount of such net loss may not exceed the cost to the purchasing corporation of the stock of the corporation which had suffered the net losses. Furthermore, the main object of Section 240 was to require taxes to be levied according to the true net income resulting from a single business enterprise, even though carried on through more than one corporation. In the present case petitioner and the Piedmont Company were not operated as a business unit until 1927, when they became affiliated. It would not effectuate the main purpose of Section 240 to permit petitioner to take advantage of net

losses sustained by the Piedmont Company before the two corporations were operated as a business unit.

The Government's position is sustained by the weight of authority, the Court of Claims and the Circuit Court of Appeals for the Second Circuit, as well as that for the Fifth, having adopted its view. The decision of the Circuit Court of Appeals for the Third Circuit to the contrary is unsound and should be disapproved. The Board of Tax Appeals, after some vacillation, has finally adopted the Government's position.

If the statute is doubtful or uncertain, it should be interpreted in the light of the consistent practical application given it by the officers charged with its administration, who have always taken the view which we urge here. Such interpretation is entitled to great weight and should not be disturbed unless clearly erroneous.

Petitioner can secure no aid from Treasury Regulations 75, which permit the deduction sought here. They are expressly made applicable only to 1929 and subsequent years, and were promulgated under the Revenue Act of 1928, which was expressly made applicable only to 1928 and subsequent years, and which changed considerably the provisions relating to consolidation and broadly authorized the Commissioner to make regulations with respect to the tax liability of affiliated corporations. So far from helping petitioner, the Act of 1928 would seem, impliedly at least, to recognize that a different rule had prevailed until then.

ARGUMENT

PETITIONER WAS NOT ENTITLED TO DEDUCT FROM ITS GROSS INCOME FOR 1927 THE NET LOSSES SUSTAINED BY THE PIEDMONT SAVINGS COMPANY IN 1925 AND 1926 WHEN THE TWO COMPANIES WERE NOT AFFILIATED

It is settled that a taxpayer has no right to any deductions from gross income except as authority for such deductions is given by statute. *Burnet* v. *Thompson Oil Co.*, 283 U. S. 301, 304; *Darby-Lynde Co.* v. *Commissioner*, 51 F. (2d) 32, 33 (C. C. A. 10th), certiorari denied, 284 U. S. xvii; *Pugh* v. *Commissioner*, 49 F. (2d) 76, 77 (C. C. A. 5th), certiorari denied, 284 U. S. xii; *Consolidated Gas Co.* v. *United States*, 65 C. Cls. 252, 259, certiorari denied, 278 U. S. 612; *New Creek Co.* v. *Lederer*, 295 Fed. 433, 435 (C. C. A. 3rd), certiorari denied, 265 U. S. 581; *Kentucky Tobacco Products Co.* v. *Lucas*, 5 F. (2d) 723, 728 (W. D. Ky.); *Planters' Cotton Oil Co.* v. *Hopkins*, 53 F. (2d) 825, 826 (C. C. A. 5th), certiorari granted March 21, 1932. Petitioner apparently does not contend that any statute or Treasury regulation expressly authorizes the deduction claimed in the present case, but relies on an interpretation of Sections 206 and 240 of the Revenue Act of 1926 as furnishing implied authority for it. Subsection (b) of Section 206 (*infra* p. 34) provides:

> If, for any taxable year, * * * any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in

> computing the net income of the taxpayer for the succeeding taxable year * * *, and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year * * *; the deductions in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.[1]

This provision must be read in the light of the well-known fact, recently commented on by this Court, that the normal mode of computation for income-tax purposes is on the basis of an annual accounting of the business transactions during the taxable year. In *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, this Court said (pp. 363, 364–365):

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. Under Sections 230, 232, and 234 (a) of the Revenue Act of 1918, 40 Stat. 1057, respondent was subject to tax upon its

[1] Section 206 (a), *infra*, p. 34, defines "net loss" as the excess of the deductions allowed by Section 234 over the gross income, with several exceptions. Section 234, *infra*, p. 36, permits the deduction of specified items, not including net losses sustained in earlier years, in the computation of the net income of a corporation.

annual net income, arrived at by deducting from gross income for each taxable year all the ordinary and necessary expenses paid during that year in carrying on any trade or business, interest and taxes paid, and losses sustained, during the year. * * *

* * * * * *

* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

The Sixteenth Amendment was adopted to enable the Government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the Government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually as the net result of all transactions within the year

> was a familiar practice, and taxes upon income so arrived at were not unknown, before the Sixteenth Amendment. * * *

See also *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. (2d) 372, 376, certiorari denied, 284 U. S. —, November 30, 1931.

In accordance with the practice thus indicated, deductions are normally restricted to the taxable year to which they are properly allocable. Section 234 of the Revenue Act of 1926, *infra* p. 36. In asserting the right to deduct the Piedmont Company's net losses for 1925 and 1926 in 1927, petitioner is seeking a privilege which is an exception to the general mode of tax computation and its right to which must therefore be conferred in clear and unmistakable terms. If there is any doubt, it should be resolved in favor of the normal method of tax computation. "The intent to exclude must be definitely expressed, where * * * the general language of the Act laying the tax is broad enough to include the subject matter." *Choteau* v. *Burnet,* 283 U. S. 691, 696. See also *Bowers* v. *Lawyers Mortgage Co.,* 285 U. S. —, decided March 14, 1932; *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, 235; *Cornell* v. *Coyne,* 192 U. S. 418, 431; *Swan & Finch Co.* v. *United States,* 190 U. S. 143, 146; *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; *Phipps* v. *Bowers,* 49 F. (2d) 996, 998 (C. C. A. 2d), certiorari denied, 284 U. S. xi, October 19, 1931; *Insurance & Title Guarantee Co.* v. *Commissioner,* 36 F. (2d) 842, 844 (C. C. A. 2d), certiorari denied,

281 U. S. 748; *Green's Advertising Agency* v. *Blair*, 31 F. (2d) 96, 98 (C. C. A. 9th); *Basham Co.* v. *Lucas*, 21 F. (2d) 550, 551 (W. D. Ky.), affirmed, 30 F. (2d) 97 (C. C. A. 6th); *Hubbard-Ragsdale Co.* v. *Dean*, 15 F. (2d) 410, 412 (S. D. Ohio), affirmed, 15 F. (2d) 1013 (C. C. A. 6th).

We submit, therefore, that the privilege granted by Section 206 (b), being in the nature of an exemption from the regular scheme of taxation, should not be extended by implication. Our position is that the privilege of deduction of net losses of earlier years is limited to the elimination of "the net income of the taxpayer * * * computed without such deduction"; and if "the taxpayer" has no net income computed without such deduction, these net losses may not be availed of in that taxable year but must be carried forward to the next succeeding year. Such is the express mandate of the statute. *Supra*, p. 9.

Petitioner contends that the "net income" referred to in Section 206 may be a minus quantity and that therefore the deduction may be taken even though "the taxpayer's" deductions under Section 234 are in excess of the gross income. We submit that Congress could not have intended a meaning so repugnant to the common understanding of the word "income." Compare *McCaughn* v. *Hersey Chocolate Co.*, 283 U. S. 488, 491–492. Petitioner's construction would lead to results plainly contrary to the expressed intent of Congress. To illustrate: Suppose corporation A suffered a net

loss of $5,000 in 1925 and that its deductions under Section 234 for 1926 exceeded its gross income for that year by $1,000. According to petitioner's contention, corporation A's net income for 1926 would be the sum of minus $6,000. Section 206 (b) directs that when the net loss for the preceding year ($5,000) is in excess of the net income computed without such deduction (minus $1,000), the excess shall be carried forward to the next succeeding year. Now the sum by which $5,000 exceeds the sum of minus $1,000 is $6,000. Hence, if petitioner's contention be sound, the sum of $6,000 may, under Section 206 (b), be carried forward to 1927 to be used as a deduction in the computation of net income for that year. If we assume that the $1,000 sum was made up of deductions which under Section 206 (a) are to be excluded in the computation of statutory net loss, the result of petitioner's construction is that sums which Section 206 (a) excludes from the amount of deductible net loss are by Section 206 (b) made deductible. No such inconsistency appears when "net income" is construed, in accordance with the common understanding, ~~sense~~, as meaning a positive sum, since in such case only the $5,000 would be carried forward to 1927.

The Government's position that the deduction under Section 206 is restricted to the elimination of net income is supported by the decisions in *Commissioner* v. *Ben Ginsburg Co.*, 54 F. (2d) 238, 239 (C. C. A. 2d); *Planters' Cotton Oil Co.* v. *Hopkins*, *supra*, 53 F. (2d) 825, 826.

In the present case the Piedmont Company is "the taxpayer" referred to in Section 206. (See argument *infra,* pp. 17–18.) It had no net income in 1927. Hence it could not avail itself in that year of the net losses it had sustained in 1925 and 1926. The statute permitted the 1926 net loss to be carried forward to 1928 to be used in the computation of net income, if any, for that year. The 1925 net loss, however, could not be so carried forward since the privilege of postponement expired in 1927. (See Section 206 (b), *supra,* pp. 8–9.) But that fact can not alter the result. Since the congressional intent to restrict the availability of the net loss deduction to the two succeeding years is clear,[2] any supposed hardship is immaterial. As the Circuit Court of Appeals for the Second Circuit said in *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 240:

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[2] Compare the report of the Senate Committee in charge of the Revenue Act of 1924, which reads in part (Senate Report No. 398, 68th Congress, 1st Session, p. 20):

> This subdivision [Sec. 206 (b)] corresponds to section 204 [b] of the existing law. It should be noticed that in the bill it is provided that the amount of the net loss shall be used as a deduction in computing net income for the succeeding taxable years; it is not allowable, however, as a deduction in computing the net loss of the succeeding taxable year, since to do this would allow the benefits of the net loss to be taken not only in the two succeeding taxable years but for an indefinite time until it was absolutely wiped out.

The Treasury Regulations issued pursuant to the provisions of Section 206 provide (Art. 1622 of Reg. 69, *infra,* p. 40):

> The income tax law has defined net income and provides the formula for its computation, and has defined net loss and prescribed the formula for its computation; these formulae are exclusive. *Botany Worsted Mills* v. *United States,* 278 U. S. 282. The congressional intent is plain, and it is the duty of the courts to give effect thereto. *United States* v. *Goldenberg,* 168 U. S. 95.

As the Piedmont Company could not deduct its 1925 and 1926 net losses in 1927, petitioner must fail. It is well settled that the affiliated group may not take a deduction in the consolidated return which is not available to the particular member corporations. *First National Bank* v. *United States,* 283 U. S. 142; *Swift & Co.* v. *United States,* 38 F. (2d) 365, 375 (n. 2), 377 *et seq.* (C. Cls.), affirmed on another point, 282 U. S. 468; *Commissioner* v. *Ginsburg Co.; supra,* 54 F. (2d) 238, 239, 240. Article 635 of Treasury Regulations 69, *infra,* p. 39, dealing with the calculation of consolidated net income, is expressly made *"subject to the provisions covering the determination of taxable net income of separate corporations."* (Italics ours.) It follows that corporations filing a consolidated return for a given taxable year may take advantage of net losses sustained by a member of the group before affiliation only to the extent that the member has net income for that year; and

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It should be noticed, however, that a "net loss" for a preceding year may not be considered in computing a "net loss" for a succeeding year.

for the reasons stated "net income" necessarily means an amount greater than zero.

We find no inconsistency between this position and the fact, urged by petitioner, that all the deductions under Section 234, *infra,* p. 36, may be taken upon the consolidated return regardless of whether the particular corporations had net income. There is no provision in Section 234, as there is in Section 206(b), to the effect that the deductions should be carried forward to the next succeeding year if in excess of gross income. As a matter of practice the taxpayer would list all its deductions under Section 234 even though in excess of gross income in order to protect itself in case some of the deductions should be disallowed. But, as we have attempted to demonstrate, *supra,* pp. 12–13, before the net loss deduction may be claimed, it must be ascertained whether there is any net income computed without the net loss. If not, the deduction may not be taken, but must be carried forward. See Article 1622 of Treasury Regulations 69, *infra,* p. 40. Article 635 of Treasury Regulations 69, *infra,* p. 39 clearly contemplates that each of an affiliated group of corporations will list all its available deductions on the consolidated return, and that the net income of the affiliated group taxed by Section 240, *infra,* p. 36, will be ascertained by deducting from the aggregate gross income the aggregate of the deductions allowable to the particular corporations. Indeed, this is the only way in which the intent of Congress to treat as a business unit that which is operated as such could be at-

tained. Thus the fair implication is that Congress intended to authorize such a method of computing the taxable income of the group. But it would be quite contrary to the purpose of recognizing the group as a business unit to permit petitioner to benefit from losses sustained by the Piedmont Company before the two corporations were operated as such. See *infra*, pp. 20–21. The business unity of the group is not to be affected by echoes of the previous failures of its constituent parts.

We have proceeded on the assumption that "the taxpayer" which may deduct the net loss under Section 206(b) is the Piedmont Company and that "the taxpayer" does not mean the group composed of affiliated corporations. On its face the language of the section would seem to require that construction, since the words "the taxpayer" obviously refer to that "taxpayer" which has suffered the net loss—here the Piedmont Company. Section 2 of the Revenue Act of 1926, *infra, p.* 34, supports this conclusion by defining "taxpayer" as "any *person* subject to a tax imposed by this Act" and "person" as (among other things) "*a* corporation." Strong evidence that "the taxpayer" was intended to have only this meaning is to be found in Section 206(g), *infra,* p. 35, extending the benefit of the section to the members of a partnership and to an estate or trust. *Expressio unius est exclusio alterius.*

Petitioner and Piedmont filed their consolidated return for 1927 under Section 240 of the Revenue

Act of 1926, *infra*, p. 36, subsection (b) of which provides:

> In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *

There is nothing to countenance the view that the affiliated group becomes "the taxpayer" within Section 206. The effect of the filing of the consolidated return is merely to make the affiliated group a tax *computing* unit. The group does not itself become the taxable unit. The tax is assessed "upon the respective affiliated *corporations.*" It is well settled that the members of the group remain the "taxpayers." *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365, 374, 375, 376; *Sweets Co.* v. *Commissioner,* 40 F. (2d) 436, 438 (C. C. A. 2d); *Beneficial Loan Soc.* v. *United States,* 48 F. (2d) 686, 687 (C. Cls.), certiorari denied, 284 U. S. x, October 19, 1931; *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 239; *Fire Companies Bldg. Corp.* v. *Commissioner,* 54 F. (2d) 488, 489 (C. C. A. 2d); *Hoffman* v. *United States,* 52 F. (2d) 269, 270 (W. D. Mo.); *Hart Glass Mfg. Co.* v. *United States,* 48 F. (2d) 435, 441–442 (C. Cls.).

A basic reason for the enactment of Section 240 was to prevent tax evasion. The Senate Commit-

tee on Finance, in proposing the section, said (Senate Report No. 617, 65th Congress, 3d Session, p. 9):

> So far as its immediate effect is concerned consolidation increases the tax in some cases and reduces it in other cases, but *its general and permanent effect is to prevent evasion which can not be successfully blocked in any other way.* (Italics ours.)

See also *Handy & Harman* v. *Burnet,* 284 U. S. 136, 141.

If petitioner's argument as to the application of the provisions for consolidated returns is justified, a device designed to prevent tax evasion is converted into a vehicle for the evasion which Congress sought to prevent. If, for example, corporation A earning a large net income purchased for a nominal consideration all the stock of corporation B which had suffered a large net loss the preceding year, they could, if petitioner's contention be adopted, file a consolidated return deducting the net loss of the preceding year, even though corporation B had no net income during the period of affiliation. In this way corporation A could secure a large reduction in tax by means of affiliation and accomplish the very result which Congress desired to eliminate. The affiliation provisions were obviously not designed to permit tax evasion by the purchase and sale of tax losses. While such evasion became impossible on January 1, 1929,[8] the number of reported

[8] When the regulations were changed on January 1, 1929, pursuant to statutory authorization, so as to permit affiliated

decisions dealing with similar attempts to evade suggests the existence of a large number of transactions of the type described which occurred before that date, the effectiveness of which for taxation purposes will turn on the decision in the present case. Intent to prevent such a result is also to be found in Article 634 of Treasury Regulations 69, *infra* p. 39, dealing with changes in affiliation during the taxable year, which indicates a purpose to exclude separate businesses from the consolidated return by requiring separate returns for the portions of the year during which there was and was not affiliation. See also *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436.

There is another reason why petitioner is not aided by Section 240. As this Court has recently declared, the primary purpose of the consolidated return provision was to require taxes to be levied according to the true net income resulting from a single business enterprise, even though it was conducted by means of more than one corporation. *Handy & Harman* v. *Burnet, supra,* 284 U. S. 136, 140. In the present case, petitioner and the Piedmont Company were not operated as a business unit until 1927, when they

---

corporations to deduct net losses suffered by a member corporation before affiliation even though it had no net income for the taxable period, careful provision was made to prevent tax evasion of the kind described in the text by limiting the amount of the deductible net loss to the cost to the affiliated group of the stock of the member which had suffered the net loss. This was an effective remedy for the evil of using the affiliation provisions for the barter of tax liability. See argument, *infra*, pp. 29–32.

became affiliated. Before that time Piedmont had suffered the net losses which petitioner seeks to deduct. To permit petitioner to take advantage of the net losses sustained by Piedmont before the two corporations were operated as a business unit not only would not effectuate the main purpose of Section 240, but would violate the rule that deductions are normally personal to the taxpayer suffering them and may not be availed of by another. *Busch* v. *Commissioner*, 50 F. (2d) 800 (C. C. A. 5th); *Planters' Cotton Oil Co.* v. *Hopkins, supra*, 53 F. (2d) 825. We submit that the purpose of Section 240 as well as the language of Section 206(b) require the construction urged by the Government.

The Government's position is sustained by authority. The Circuit Court of Appeals for the Second Circuit and the Court of Claims, as well as the Circuit Court of Appeals for the Fifth Circuit, have reached the conclusion for which we contend. In *Swift & Co.* v. *United States, supra*, 38 F. (2d) 365, 375 n. 2, 377 *et seq.*, the Court of Claims had before it Section 204 (b) of the Revenue Act of 1918, *infra*, p. 33, which allowed a taxpayer to deduct its net loss for a given year from its net income for the *preceding* year. A corporation which became a member of an affiliated group in 1919 sustained a net loss in that year. The affiliated corporations sought to deduct this loss in computing their 1918 taxes. In the course of a careful opinion the Court of Claims said (p. 379):

> Of course this net loss will not be used in the consolidated computation for 1918 for the reason that this corporation was not a member of the 1918 group * * *.

Footnote 3 on pages 378–379 of the opinion [38 F. (2d)] contains an illuminating discussion of the problem in the present case. The court says (p. 378):

> Corporation E's [the corporation which was a member of the affiliated group in 1919 but not in 1918] net loss would, of course, not affect the consolidated net income computation in 1918, for the reason that it was not a member of the affiliated group, and the company did not exist in the group to which the net loss might be applied.

The *Swift* case was approved by the Circuit Court of Appeals for the Second Circuit in *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436, which also dealt with Section 204 (b) of the Revenue Act of 1918. There a Virginia corporation was affiliated with two other corporations until October 31, 1919, but not for the remaining two months of the calendar year 1919. In the period ending October 31, 1919, the affiliated group as a whole had net income, none of which was attributable to the Virginia corporation. One of the contentions was that the net loss of the Virginia corporation suffered during the last two months of the calendar year should be used as a deduction from the income of the affiliated group. The court said (p. 439):

> The Virginia corporation having had no income during the period ending October 31, 1919, we need not consider section 204 (b), for, even if it were construed to be applicable, the Virginia corporation could gain no benefit *from crediting its losses of the last two months against its income of the prior period.* (Italics ours.)

In *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, the Circuit Court of Appeals for the Second Circuit considered the identical question presented here, and, following the decision of the Court of Claims in *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365, and its own decision in *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436, denied the claim of the taxpayer.

The Circuit Court of Appeals for the Fifth Circuit followed its decision in the present case in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* 53 F. (2d) 825. The District Courts in the present case (R. 8–10) and the *Planters' Cotton Oil* case, 47 F. (2d) 659 (N. D. Tex.), reached the same result.

The only court decision to the contrary is that of the Circuit Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846. The facts in that case, as revealed by the findings of the Board of Tax Appeals, 16 B. T. A. 1310, are as follows: John M. Buckland owned practically all the stock of a railroad company. He also owned and operated a business which he incorporated on January 1, 1924, as the National Slag Company, owning practically all its stock. The railroad

company suffered net losses in 1922, 1923, and 1924. The Slag Company had net income for 1924. The two companies filed a consolidated return for 1924, and the question was whether the railroad's net losses for 1922 and 1923 could be deducted. The fact that the same person was the beneficial owner of both enterprises during the years involved seems to have had an important bearing upon the court's decision. The court gave very little consideration to the statutory provisions, but concluded (p. 847):

> In view of the fact that Buckland owned both companies before and after incorporation of the slag company, it seems *on principle* that the provisions of section 206 should apply to the consolidated return of these affiliated companies. The return of these companies should be treated as an economic unit, and not as separable into various component parts, or individual returns. * * * That one of these instrumentalities forming one of the component parts in the consolidated return was not incorporated until after the losses sought to be deducted were sustained, does not make the provisions *on principle* inapplicable to the return, for it was in fact the same instrumentality, but acting in 1924 through corporate forms. (Italics ours.)

It is difficult to determine what the court meant by the words "on principle." If there is any room for the application of "principle" in the interpretation of Section 206, it should be in the direction of literal construction for the reasons we have stated,

supra, pp. 9–12. While the *Slag Company* case was slightly different from the present case in that one man owned both businesses *before* as well as during affiliation, the Circuit Court of Appeals for the Fifth Circuit held the fact variation immaterial in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* 53 F. (2d) 825, which applied the rule of the instant case to facts closely similar to those in the *Slag Company* case. The Circuit Court of Appeals for the Second Circuit has also refused to follow the *National Slag Company* case. *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 240. We submit that the decision in the *Slag Company* case is unsound.

The Board of Tax Appeals after some vacillation has finally adopted the view urged by the Government. In *Alabama By-Products Corp.* v. *Commissioner,* 16 B. T. A. 1073, the Board dealt with Section 204 of the Revenue Act of 1918, *infra* p. 33, and took the position for which we contend. It lucidly expressed its interpretation of the statute as follows (pp. 1078–1079):

> Since, under the statute, each member of an affiliated group is a "taxpayer" and the relief granted by section 204 is given to "any taxpayer," it is our opinion that an affiliated corporation, which suffered a net loss in 1919, prior to the beginning of the period of affiliation, and which net loss exceeded the amount of its net income for 1918, is entitled to deduct the excess of such net loss from its individual net income for 1920, and

> to that extent the consolidated net income is thus reduced.
>
> However, if the corporation which sustained the net loss in 1919 has no individual net income for 1920, the excess of such net loss over its 1918 net income may not be taken as a deduction, for the reason that such taxpayer has no income from which it can be deducted, and a net loss sustained by one taxpayer may not be deducted from the net income of another taxpayer or group of taxpayers, even though it be an affiliated corporation and included in a consolidated return with another or other corporations.

This decision was followed in *National Slag Co.* v. *Commissioner, supra,* 16 B. T. A. 1310, under Section 206 (b) of the Revenue Act of 1924, which was identical with Section 206 (b) of the Act of 1926, *infra* p. 35, involved in the present case. On rehearing, the Board (two members dissenting) reversed its decision in the *Alabama By-Products* case and announced that the *National Slag* case was overruled. 18 B. T. A. 919. The reversal was predicated on a supposed difference in meaning between the first and second clauses of Section 204 (b) of the Act of 1918, one of which provided that the net loss should be "deducted from the net income" and the other that it should be "allowed as a deduction in computing the net income." See also *Burnet* v. *Moore Cotton Mills Co.*, 49 F. (2d) 59 (C. C. A. 4th).[4] In *Warren-Nash Motor Corp.* v. *Commis-*

[4] The petitioner in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* which is to be argued immediately after this case,

sioner, 21 B. T. A. 897, where the Board was dealing with Section 204 of the Act of 1921, *infra* p. 33, it said that the clause in issue was the one providing that the net loss should be "deducted from the net income," and that therefore (p. 900):

> Following the principle of the *Alabama By-Products Co.* case, the net loss sustained in 1922 is deductible by the corporation which sustained that loss from its net income of the first succeeding taxable year, that is, 1923, to the extent of that net income. Since, in the first succeeding taxable year the deduction may not exceed the net income of that year, there being no net income, there may be no deduction.
>
> We, therefore, agree with the respondent that the deduction in 1923 is allowable only to the extent that the Nash-Newark Co., which sustained the net loss in 1922, had net income in 1923. Since it had no net income in 1923, there is no basis for the deduction claimed by the petitioner in that year.

After the decision of the court below and the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, the Board of Tax Appeals, without citing its earlier decisions, adopted the construction which we urge. *Bowman Hotel Corp.* v. *Commissioner,* 24 B. T. A. 1193, 1209–1210.

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contends that this supposed difference in meaning throws light upon the question presented here. Assuming that there is a difference in meaning which has validity in cases like *Burnet* v. *Moore Cotton Mills Co., supra,* we submit that it has none here.

The consistent administrative interpretation of Section 206 and its earlier prototypes is in accord with the Government's position in the instant case. In 1924, the Solicitor of Internal Revenue took our view. Law Opinion No. 1113, Cumulative Bulletin, III–2, p. 36, 42. The relevant portion of this opinion appears in footnote 2, p. 375, of *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365. In 1928, the General Counsel of the Bureau of Internal Revenue, in General Counsel Memorandum No. 3266, VII–1 C. B. 205, approved the Solicitor's opinion, and in 1930, in Memorandum No. 8132, IX–1 C. B. 287, he accepted the decision of the Court of Claims in *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365. He restated his conclusions to the same effect in Memorandum No. 8618, IX–2 C. B. 180. See also Memorandum No. 8686, IX–2 C. B. 306.

The Commissioner did not acquiesce in the *Alabama By-Products* case, see IX–2 C. B. 67, nor in the following decisions which applied it. *Buckie Printers' Ink Co.* v. *Commissioner,* 19 B. T. A. 943, nonacquiescence in X–1 C. B. 76; *Pittsburgh Gasoline Co.* v. *Commissioner,* 21 B. T. A. 297, nonacquiescence in X–1 C. B. 90; *General Box Corp.* v. *Commissioner,* 22 B. T. A. 725, nonacquiescence in X–1 C. B. 80; *Arrow Coal & Ice Co.* v. *Commissioner,* 22 B. T. A. 1341, nonacquiescence in Int. Rev. Bull., Vol. X, No. 40, p. 1; *Tolerton & Warfield Co.* v. *Commissioner,* 23 B. T. A. 892, nonac-

quiescence in Int. Rev. Bull., Vol. XI, No. 4, p. 2; *Hawley Investment Co.* v. *Commissioner*, 23 B. T. A. 953, nonacquiescence in Int. Rev. Bull., Vol. XI, No. 3, p. 2.

If it be considered that Section 206 is ambiguous or uncertain, then we submit that the consistent practical application given it by the officers charged with its enforcement is entitled to great weight and should not be disturbed unless clearly erroneous. *Universal Battery Co.* v. *United States*, 281 U. S. 580, 583; *Brewster* v. *Gage*, 280 U. S. 327, 336; *Swendig* v. *Washington Co.*, 265 U. S. 322, 331; *Logan* v. *Davis*, 233 U. S. 613, 627.

Petitioner cites Treasury Regulations 75. (Br. 13, 14.) They do not aid it. By express provision they are applicable only to 1929 and subsequent years. (See *infra*, p. 41.) Regulations 75 were promulgated under the Revenue Act of 1928, c. 852, 45 Stat. 791. That Act has no application to the years now in question. The Committees which drafted the Act substantially rearranged the provisions of earlier Acts and were impressed with the necessity of making a fresh start. House Report No. 2, 70th Congress, 1st Session, p. 11; Senate Report No. 960, 70th Congress, 1st Session, p. 17. For that reason the provisions of the income tax title of the Act were made applicable only to 1928 and subsequent years. Section 1, *infra*, p. 37. The Senate Committee on Finance said with reference

to the provisions of the Act (Senate Report No. 960, 70th Cong., 1st sess., p. 18):

> They have no effect whatsoever on taxes imposed for prior taxable years, nor do the provisions of the 1926 income tax title have any effect on the computation of tax for 1928 or later years. For this reason the income tax title of the 1926 Act is not repealed by the bill and remains in force for the collection of taxes for 1925, 1926, and 1927 * * * [with exceptions not here material].

See also the statement of the managers of the bill on the part of the House, House Report No. 1882, 70th Congress, 1st Session, p. 10.

The consolidated return provisions of the Revenue Act of 1928 are appreciably different from those of the former Acts. Section 141 (d), *infra* p. 38, restricts affiliation to the case of "one or more chains of corporations connected through stock ownership with a common parent corporation." Section 141 (b), *infra* p. 38, authorizes the Commissioner, with the approval of the Secretary, to "prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted *in such manner as clearly to reflect the income and prevent avoidance of tax liability.*" (Italics ours.) The import of this authority,

under which the Commissioner promulgated Article 41 (c), *infra*, p. 41, is reflected in the report of the managers of the bill on the part of the House, House Report No. 1882, 70th Cong., 1st sess., p. 16, where it is said:

> Among the regulations which it is expected that the commissioner will prescribe are: * * * (3) the extent to which and the manner in which net losses sustained by a corporation before it became a member of the group shall be deducted in the consolidated return * * *.

Thus it is apparent that Congress specifically granted to the Commissioner authority to permit and control deductions of the kind involved in the present case. Section 141 of the 1928 Act provides a new basis for the filing of consolidated returns and a new scheme for the taxation of affiliated corporations. The regulations promulgated under it have no bearing upon the question in this case, and they certainly can not be treated as an administrative construction of the earlier and unlike statutory provisions, for the administrative construction of those Acts, as reflected in the Commissioner's action in the present case, was quite different. The present regulations, issued under the new statutory authority, effectively prohibit the acquisition of net losses through the purchase for a nominal sum of the stock in a corporation which suffered them, by destroying the incentive for such acquisition solely for tax purposes. But the statutes with which we

are now dealing did not permit the use of net losses by an affiliated group under the circumstances of this case at all, and regulations similar to those now in force were neither necessary nor authorized by law. The present regulations are based on a statute which, impliedly at least, recognized that a different rule had prevailed until then. *Brewster* v. *Gage, supra,* 280 U. S. 327, 337.

CONCLUSION

It is respectfully submitted that the decision of the court below is correct and should be affirmed.

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APRIL, 1932.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1918 provided in part as follows (c. 18, 40 Stat. 1057, 1061):

> SEC. 204 (b). If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

The Revenue Act of 1921 provided in part as follows (c. 136, 42 Stat. 227, 231):

> SEC. 204 (b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory

to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such suceeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Section 206 (b) of the Revenue Act of 1924 (c. 234, 43 Stat. 253, 260) was identical with Section 206 (b) of the Act of 1926, *infra*, p. 35.

The Revenue Act of 1926 provided in part as follows (c. 27, 44 Stat. 9, 17, 41, 46):

SEC. 2 (a). When used in this Act—

(1) The term "person" means * * * a corporation.

* * * * *

(9) The term "taxpayer" means any person subject to a tax imposed by this Act.

NET LOSSES

SEC. 206 (a). As used in this section the term "net loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

* * * * *

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to paragraph (2) of subdivision (c) of section 204;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * * *

(g) The benefit of this section shall be allowed to the members of a partnership, to an estate or trust, * * * under regulations prescribed by the Commissioner with the approval of the Secretary.

NET INCOME OF CORPORATIONS DEFINED

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206 * * *.

* * * * * *

DEDUCTIONS ALLOWED CORPORATIONS

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *;

(5) Debts ascertained to be worthless and charged off within the taxable year * * *;

* * * * * *

CONSOLIDATED RETURNS OF CORPORATIONS

SEC. 240. (a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such re-

turn. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *

Section 117 (b) of the Revenue Act of 1928 (c. 852, 45 Stat. 825) was identical with Section 206 (b) of the Act of 1926, *supra*, p. 35. The Act of 1928 also provided (45 Stat. 791, 831):

Sec. 1. Application of Title.

The provisions of this title shall apply only to the taxable year 1928 and succeeding taxable years. * * *

SEC. 141. Consolidated Returns of Corporations—1929 and Subsequent Taxable Years.

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated

return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

* * * * * *

(d) *Definition of "affiliated group."*—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) A consolidated return shall be made only for the domestic corporations within the affiliated group. * * *

Treasury Regulations 69 promulgated under the Revenue Act of 1926 provide in part as follows:

ART. 634. *Change in ownership during taxable year.*—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership, and each should file a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

ART. 635. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of inter-

company transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * * In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

ART. 1622. *Claim for allowance of net loss.*—A taxpayer sustaining for any taxable year a "net loss" as defined in section 206 (a) and article 1621 may file a claim therefor with his return for the succeeding taxable year (referred to in article 1623 as the "second year"): The claim should contain a concise statement setting forth the amount of the net loss and all pertinent facts relative thereto, including a schedule showing the computation of the net loss in accordance with section 206 and articles 1621 and 1626. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a "net loss," the amount of such net loss may be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income (computed without such deduction) for that year, the amount of the excess may be carried over and allowed as a deduction in computing the net income for the next succeeding taxable year (referred to in article 1623 as the "third year"). It should be noticed, however, that a "net loss"

for a preceding year may not be considered in computing a "net loss" for a succeeding year. (See section 206 (a).)

Treasury Regulations 75 promulgated under the Revenue Act of 1928 provide in part as follows:

APPLICATION OF REGULATIONS

(a) 1929 and Subsequent Years

These regulations are applicable only to the taxable year 1929 and to subsequent taxable years.

* * * * *

NET LOSSES

ART. 41. (c) *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*

A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

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